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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)
)
Consumer Federal of America, International) RM No. 9210
Communications Association and National Retail)
Federation Petition Requesting Amendment of)
the Commission's Rules Regarding Access Charge)
Reform and Price Cap Performance Review for)
Local Exchange Carriers)

**COMMENTS
OF THE
UNITED STATES TELEPHONE ASSOCIATION**

Its Attorneys:

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Attachment

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SUMMARY

This petition should be dismissed pursuant to Section 1.401(e) of the Commission's rules as it is completely without merit, both procedurally and substantively. Petitioners' request was already rejected by the Commission in CC Docket No. 96-262. Both incumbent LECs and CLECs opposed the prescriptive approach. Alfred Kahn, in a statement submitted by USTA warned that the prescriptive approach would drastically impair the ability of incumbent LECs to invest in the modernization of the telecommunications infrastructure. Further, there is no evidence that a prescriptive approach will provide any benefits to petitioners based on the failure of interexchange carriers to pass through access charge reductions. Petitioners' assertions regarding UNEs and their impact on the development of competition is refuted in the attached paper by Richard Schmalensee and William Taylor of NERA. USTA also provides updated information on the status of competition which dispels petitioners' claims that competition is not developing sufficiently. USTA urges the Commission to reject the petition.

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UNITED STATES TELEPHONE ASSOCIATION**

The United States Telephone Association (USTA) respectfully submits its comments in the above-referenced proceeding. USTA is the principal trade association of the incumbent local exchange carrier (ILEC) industry. Its members provide over 95 percent of the ILEC-provided access lines in the U.S.

On December 9, 1997, the Consumer Federation of America, International Communications Association and National Retail Federation (petitioners) filed a Petition for Rulemaking requesting that the Commission initiate a rulemaking proceeding to immediately prescribe interstate access rates to cost-based levels. This petition should be summarily dismissed pursuant to Section 1.401(e) of the Commission's rules as it is completely without merit both procedurally and substantively.¹

¹Section 1401(e) states, "Petitions which are moot, premature, repetitive, frivolous, or
(continued...)"

At best, this filing is a really out-of-time request for reconsideration of the Commission's decision to utilize a market-based approach to access pricing. In the Commission's Order in CC Docket No. 96-262, the Commission properly determined that "competitive markets are far better than regulatory agencies at allocating resources and services efficiently for the maximum benefit of consumers" and thus adopted a market-based approach for access prices.² "We conclude, based on our experience in exchange access and other telecommunications markets and the record in this proceeding, that a market based approach to reducing access charges will, in most cases, better serve the public interest...we believe that this approach is most consistent with the pro-competitive, deregulatory policy contemplated by the 1996 Act."³

The Commission specifically rejected the prescriptive approach suggested by petitioners for several reasons. The Commission noted that accurate, forward-looking cost models are not available at the present time to determine the economic cost of providing access service. "[L]acking the tools for making accurate prescriptions, precipitous action could lead to significant errors..."⁴ The Commission was concerned that such errors could have a detrimental impact on the provision of universal service, could further impede the development of

¹(...continued)
which plainly do not warrant consideration by the Commission may be denied or dismissed without prejudice to the petitioner."

²Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges, *First Report and Order*, CC Docket Nos. 96-262, 94-1, 91-213 and 95-72, FCC 97-158 (rel. May 16, 1997), at ¶42; *Second Order on Reconsideration*, FCC 97-368, (rel. Oct. 9, 1997), *review pending sub nom. Southwestern Bell Tel. Co. v. FCC*, No. 97-2618 (8th Cir.).

³*Id.* at ¶44.

⁴*Id.* at ¶46.

competition in local markets and could disrupt existing services. Thus, petitioners' request is clearly repetitive and must be dismissed. Petitioners had an opportunity to seek reconsideration at the appropriate time. Their failure to file in a timely manner should not be countenanced.

The Commission also recognized that the market-based approach may take several years to drive costs to competitive levels.⁵ As the Commission acknowledged, removing the distortions and inefficiencies in the current access rate structure cannot be accomplished on a flash cut basis without severe consequences. The Commission stated that it would release subsequent orders with detailed rules to implement the market-based approach and to address the problem of ensuring the recovery of historical costs. These orders have not been released. Petitioners filed their request on December 9, 1997 before the access reform order even became effective on January 1, 1998. Thus, this petition is grossly premature and petitioners' flawed suppositions as to future outcomes should be dismissed as frivolous.

Petitioners base their request on statements that are either irrelevant, inaccurate or both. First, the Commission's decision to rely on a market-based approach was strongly supported by commenting parties, including incumbent LEC competitors. For example, Time Warner stated that, "[a] properly designed and enforced market-based approach to lowering interstate access rates has several advantages over a prescriptive approach. First, as the Commission has long recognized, prices set by prescriptive regulation are not as efficient as those determined by a competitive market. Moreover, while a prescriptive approach might increase short-term static efficiencies (bringing prices closer to the ILECs' costs), a market-based approach will establish

⁵*Id.* at ¶45. The Commission also stated that if competition did not emerge, it would prescribe rates in the future to bring them into line with forward-looking costs. (at ¶48).

the preconditions for the development of more beneficial dynamic efficiencies (the entry of firms with costs that are lower than the ILECs'). For this reason, the development of competition over the long term would be more beneficial than the short term benefits of prescription."⁶ Teleport Communications Group noted that "[p]rices based on market prices, rather than regulatory rules, are more likely to lead to appropriate results...".⁷ The Association for Local Telecommunications Services explained, "The central reason both Congress and the Commission have concluded markets should be relied upon to set prices rather than regulation is that regulation, despite the best efforts of the regulators, has proven totally unable to replicate competitive results. Lapsing back now to 'prescriptive' regulation is a white flag of surrender totally inconsistent with the Telecommunications Act of 1996, as well as with the Commission's longstanding goal of furthering competition."⁸

In a statement submitted by USTA, Alfred E. Kahn described some of the adverse impacts of a prescriptive approach. "The problem raised by the proposed prescriptive path is not confined to its effect on the incentives of both incumbent and competitive LECs to invest in the modernization of our telecommunications infrastructure. Even more directly and obviously, it would inevitably impair drastically the ability of the incumbents to do so."⁹ Such a result harms

⁶Comments of Time Warner, CC Docket No. 96-262, filed January 29, 1997 at 19.

⁷Comments of Teleport Communications Group, CC Docket No. 96-262, filed January 29, 1997 at 4.

⁸Comments of Association for Local Telecommunications Services, CC Docket No. 96-262, filed January 29, 1997 at 21.

⁹Statement of Alfred E. Kahn on FCC's Proposed Reforms of Carrier Access Charges, USTA Reply Comments, CC Docket No. 96-262, filed February 14, 1997 at Attachment 1.

not only the telecommunications providers who rely on the public switched network to provide service to their customers, but more important, the very consumers that petitioners purport to represent. Prices which are not market-based will give the wrong signals regarding usage, which will incent inefficient firms to enter the market, as well as chill investment.¹⁰ Firms will have no incentive to become facilities-based competitors if the costs necessary to invest in the infrastructure cannot be recovered because prices do not reflect market conditions. Chilling incentives to invest in the infrastructure through a prescriptive approach to setting prices will threaten the maintenance of high quality, reliable service, stifle innovation thereby reducing customer options and, ultimately, jeopardize universal service. In short, a prescriptive approach will only serve to eliminate the benefits of competition which Congress intended to provide to consumers.

Further, there is no evidence that a prescriptive approach will benefit petitioners. Incumbent LECs today operate under prescriptive regulation. For example, those incumbent LECs regulated under price cap regulation must reduce their access charges each year to reflect productivity gains over and above productivity gains achieved by our nation. Since 1991, price cap-regulated LECs have reduced access charges paid by the interexchange carriers by a total of \$11 billion dollars. If petitioners have not experienced a concomitant reduction in their toll bills over that time period, it would seem fairly obvious that petitioners would be better served if their

¹⁰See, also, J. Gregory Sidak and Daniel F. Spulber, Affidavit, CC Docket No. 96-262, USTA Comments filed January 29, 1997 at Attachment 3 and Reply Affidavit, USTA Reply Comments filed February 14, 1997 at Attachment 2; and Richard Schmalensee and William E. Taylor, "Economic Aspects of Access Reform", CC Docket No. 96-262, USTA Comments filed January 29, 1997 at Attachment 1 and "Economic Aspects of Access Reform: A Reply", USTA Reply Comments filed February 14, 1997 at Attachment 3.

efforts were directed toward convincing incumbent long distance carriers that they should pass these reductions through to all long distance customers. It is highly unlikely that further prescriptive measures mandating incumbent LECs to make additional and completely arbitrary reductions in access charges will result in any such benefits for petitioners.

Petitioners seem to imply that the availability of unbundled network elements has not encouraged competition in access markets. Attached hereto is a paper written by Richard Schmalensee and William Taylor, National Economic Research Associates, which describes the recent marketplace developments which have resulted in an urgent need for increased access pricing flexibility, not further regulation.¹¹ This paper explains that the existence of interconnection agreements with UNEs at cost-based rates makes many incumbent LEC customers potential competitive LEC (CLEC) customers, constrained only by the ability of the competitor to convince the customer to switch access providers. These customers are vulnerable to competitors because UNEs can be used as substitutes for incumbent LEC-provided access services as well as retail local exchange services. Schmalensee and Taylor conclude that the existence of interconnection agreements should give the Commission a sense of urgency to act by permitting market forces to substitute for regulatory constraints.

Petitioners' assertion that competition is not developing sufficiently is simply wrong. In fact, the developments described by Schmalensee and Taylor based on data gathered late last year are already out of date, yet the fact remains that incumbent LECs have taken the steps required by the 1996 Act to open their markets to competition.

¹¹Richard Schmalensee and William Taylor, "The Need for Carrier Access Pricing Flexibility in Light of Recent Marketplace Developments."

As of January 1998, more than 2400 interconnection agreements among incumbent LECs and their wireline and wireless competitors have been signed. Over 1200 certificates permitting competitive local telephone companies to operate have been granted covering all fifty states and the District of Columbia. Hundreds of certificates are pending. Of course, CLECs do not have to provide service statewide and USTA's research shows that competitors have announced plans to offer service in nearly 800 cities. More than six thousand number exchanges have been assigned to competitors and more than 1600 collocation points have been established.

The Regional Bell Operating Companies and GTE have spent \$4 billion on operational support systems, new employees, number portability and other capital expenditures to open their networks to new entrants. The six largest incumbent LECs currently process more than 8,000 competitive orders daily. These companies have dedicated over 8,000 employees to serve the needs of competitors. As a result of these efforts, incumbents LECs have lost nearly 1.5 million telephone lines to competitors, nearly all lucrative business customers.¹²

In the Bell Atlantic region, more than 35,000 unbundled loops and more than 208,000 resold lines were in service by November 1997 along with 212,000 interconnection trunks and 401 collocation sites.

Ameritech has provided more than 70,000 unbundled loops and 95,000 interconnection trunks. Currently, competitors are using Ameritech services and facilities to serve 230,000 lines in Michigan, 243,000 lines in Illinois, and almost 600,000 lines region wide. This does not include lines provisioned by competitors on their own facilities. Ameritech has provisioned lines

¹²See, Presentation of Roy M. Neel, President and CEO, USTA, FCC En Banc Hearing on Local Competition, January 29, 1998.

to competitors in most of its wire centers, with 47 CLEC switches deployed. By the end of 1998, Ameritech expects the number of switches to grow to 97. With capacity to serve 80,000 lines per switch, competitors will then have the capability to serve over 7.75 million lines in the Ameritech area.

In the BellSouth region, more than 320 competitors have been authorized to provide service, 41 of which have switching capability. More than 8,000 unbundled loops and 211,000 resold lines are now in service. 76 percent of resold lines and 65 percent of unbundled loops are concentrated in just two states. BellSouth has lost three million lines to intraLATA toll competitors.

In the SBC region, more than 560,000 access lines have been lost to CLECs through the end of 1997 through resale or through the establishment of new facilities-based service.¹³ More than 174,000 interconnection trunks have been provided to competitors. There are close to 2400 competitors' hi-cap lines in service.

The growth rates are even more dramatic. In the Bell Atlantic region, unbundled loops and minutes of use have doubled since this time last year. Resold lines grew by a factor of over seven. In the Ameritech region, unbundled loops have practically doubled in one year, resold lines grew by a factor of twelve and competitors' lines in the region grew by a factor of over four. In the SBC region, in September 1997 alone, 57,000 access lines were converted to resale and 12,000 to 15,000 orders were being processed weekly. In Texas, there was a 140 percent increase in resold lines from June to August 1997.

¹³SBC Ex Parte Letter, January 26, 1998, CC Docket No. 97-121.

Competitors have been very successful in capturing significant incumbent LEC special access traffic and in substituting their direct connections for incumbent LEC switched access to serve high volume customers. In fact, Schmalensee and Taylor point out that competitors have been able to erode incumbent LEC access markets even before the Telecommunications Act was enacted. For example, competitive access provider (CAP) and CLEC revenues doubled between 1995 and 1996. CLEC revenues and market share are predicted to grow from \$2 billion to \$3.3 billion or by sixty percent in 1998 and to \$5 billion or by sixty-six percent in 1999 according a study recently released by Merrill Lynch.¹⁴

Competitive access providers have fiber networks in operation in over 300 cities. CAP investment in fiber is growing at a significantly faster rate than that of the incumbent LECs. By the end of 1996, the CAPs aggregate percentage growth rate was almost seven times that of the incumbent LECs.

GTE reported that as of August 1997, approximately 19,250 equivalent DS 1 facilities were provisioned by CAP facilities in major GTE markets. For the same period, total GTE DS1 facilities were 104,397 representing a loss of almost 19 percent.

A 1996 study commissioned by SBC showed that in the Dallas and Houston markets, SBC had already lost approximately 43 and 38 percent, respectively, of the high capacity special access market as of the fourth quarter of 1994.¹⁵ Even by the first quarter of 1995, incumbent LECs' high capacity service losses to competitors were already as high as 39 percent in

¹⁴*Communications Daily*, "CLECs Revenue and Market Share Predicted to Grow 60% Next Year", Vol.17, No. 237, December 10,1997 at 2.

¹⁵SBC Ex Parte Letter, CC Docket No. 96-262, January 26, 1998.

Philadelphia, 39 percent in Pittsburgh, 32 percent in Washington, D.C., 27 percent in Baltimore, 39 percent in Los Angeles, 37 percent in San Francisco, 50 percent in New York City, 44 percent in the greater New York metropolitan region and 37 percent in Boston. Overall, by March of 1995, CLECs and CAPs had captured 10 to percent of the nationwide carrier access market and had resulted in LEC reductions in rates on comparable service by 20 to 30 percent between 1991 and 1994.

Now, as a result of the 1996 Act, competitors have even more tools to assist them in competing in access markets and the trends in access markets as described above are continuing at an even faster rate. By the third quarter of 1996, competitors had captured 55.2 percent of the high capacity Chicago market and 48.8 percent of the Grand Rapids market. Bell Atlantic estimated that its market share losses for 1996 for high capacity services were 53.5 percent in Southern Midtown Manhattan and 45.7 percent in the greater New York City Metropolitan area. SBC reported that its losses had grown to 49 percent in Los Angeles, 48 percent in San Francisco, 27 percent in Sacramento, 30 percent in San Diego, and 58 percent in Orange County by the third quarter of 1997.¹⁶

Contrary to petitioners' assertions, Schmalensee and Taylor explain that there are no barriers to continued growth by competitors. The appellate court decisions referred to by petitioners have not stifled competition, but have only clarified jurisdictional responsibilities consistent with the 1996 Act. In fact, petitioners' claim that due to appellate court decisions "resale is the only viable means for many CLECs to compete..." must be questioned in light of

¹⁶SBC Ex Parte Letter, CC Docket No. 96-262, January 26, 1998.

the recent announcement by MCI that it will no longer attempt to resell local service to residential customers, but will instead concentrate on providing facilities-based service to business customers. MCI's decision was based on the fact that implicit subsidies which keep residential rates far below actual costs in furtherance of universal service makes entry in that market unprofitable. Of course, other CLECs have successfully entered local telecommunications markets through resale and plan to continue to utilize resale while others are moving to more facilities-based offerings.¹⁷

USTA urges the Commission to dismiss this petition and to continue its efforts to bring the benefits of competition to all consumers by eliminating asymmetric regulation and allowing incumbent LECs to compete in the marketplace.

Respectfully submitted,

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¹⁷See, Presentations on Status of Local Telephone Competition, FCC En Banc Hearing, January 29, 1998.

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**THE NEED FOR CARRIER ACCESS PRICING FLEXIBILITY
IN LIGHT OF RECENT MARKETPLACE DEVELOPMENTS**

A Primer

by

Richard Schmalensee and William Taylor

QUALIFICATIONS

Richard Schmalensee is the Gordon Y. Billard Professor of Economics at the Massachusetts Institute of Technology (MIT), Deputy Dean of the MIT Sloan School of Management, and Director of MIT's Center for Energy and Environmental Policy Research. He also is a Special Consultant to National Economic Research Associates, Inc., a Director of the Long Island Lighting Company, a former Member of the EPA's Environmental Economics Advisory Committee, and a Member of the EPA's Clean Air Act Compliance Analysis Council. He served as a Member of President Bush's Council of Economic Advisors with primary responsibility for domestic and regulatory policy, including environmental and telecommunications policy and for U.S. assistance to Central and Eastern Europe. He served for several years as a consultant to the Bureau of Economics of the Federal Trade Commission.

Dr. Schmalensee has done extensive research on aspects of industrial organization and antitrust policy, particularly nonprice competition and conditions of entry. He has also studied the telecommunications industry, the electric power sector and general issues of regulation and regulatory reform. He has testified in both federal and state courts, before several Congressional committees, and before the Federal Trade Commission, and he has served as a consultant on regulatory and competitive issues to numerous organizations in the United States and abroad.

He received his S.B. and Ph.D. degrees in economics from MIT and taught for some years at the University of California, San Diego. At MIT, he teaches graduate courses in industrial organization, its applications to management decisions, government regulation and government/business relations. He has published over 60 articles in professional journals, including *The American Economic Review*, *The RAND Journal of Economics*, *The Harvard Law Review*, *The Journal of Econometrics*, *Public Utilities Fortnightly*, *Econometrica*, *The Journal of Law and Economics*, *The Journal of Industrial Economics*, *The Economic Journal*, *The Antitrust Law Journal*, *The International Journal of Industrial Organization*, *The Quarterly Journal of Economics*, and *The Journal of Economic Perspectives*.

He is the author of *The Economics of Advertising* and *The Control of Natural Monopolies* and co-author of *Markets for Power*. He is also co-editor of the *Handbook of Industrial Organization* and founding editor of the MIT Press Regulation of Economic Activity monograph series. He has served on the editorial boards of *The American Economic Review*, *Zeitschrift für Nationalökonomie*, *The International Journal of Industrial Organization*, *The Journal of Economic Perspectives*, *Recherches Economiques de Louvain*, and *The Journal of Industrial Economics*. He has served on the Executive Committee of the American Economic Association and is a Fellow of the Econometric Society and the American Academy of Arts and Sciences.

William Taylor is a Senior Vice President of National Economic Research Associates, Inc. (NERA), head of its telecommunications economics practice and head of its Cambridge office. He received a B.A. degree in economics, *magna cum laude*, from Harvard College in 1968, a master's degree in statistics from the University of California at Berkeley in 1970, and a Ph.D. in Economics from Berkeley in 1974, specializing in industrial organization and econometrics. He has taught and published research in the areas of microeconomics, theoretical and applied econometrics, and telecommunications policy at academic institutions (including the economics departments of Cornell University, the Catholic University of Louvain in Belgium, and the Massachusetts Institute of Technology) and at research organizations in the telecommunications industry (including Bell Laboratories and Bell Communications Research, Inc.). He has participated in telecommunications regulatory proceedings before state public service commissions, the Federal Communications Commission and the Canadian Radio-Television and Telecommunications Commission concerning competition, incentive regulation, price cap regulation, productivity, access charges, telecommunications mergers, pricing for economic efficiency, and cost allocation methods for joint supply of video, voice and data services on broadband networks.

His articles have appeared in numerous telecommunications industry publications as well as *Econometrica*, *the American Economic Review*, *the International Economic Review*, *the Journal of Econometrics*, *Econometric Reviews*, *the Antitrust Law Journal*, *The Review of Industrial Organization*, and *The Encyclopedia of Statistical Sciences*. He has served as a

referee for these journals (and others) and the National Science Foundation and has served as an Associate Editor of the *Journal of Econometrics*.

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He is the author of *The Economics of Advertising* and *The Control of Natural Monopolies* and co-author of *Markets for Power*. He is also co-editor of the *Handbook of Industrial Organization* and founding editor of the MIT Press Regulation of Economic Activity monograph series. He has served on the editorial boards of *The American Economic Review*, *Zeitschrift für Nationalökonomie*, *The International Journal of Industrial Organization*, *The Journal of Economic Perspectives*, *Recherches Economiques de Louvain*, and *The Journal of Industrial Economics*. He has served on the Executive Committee of the American Economic Association and is a Fellow of the Econometric Society and the American Academy of Arts and Sciences.

William Taylor is a Senior Vice President of National Economic Research Associates, Inc. (NERA), head of its telecommunications economics practice and head of its Cambridge office. He received a B.A. degree in economics, *magna cum laude*, from Harvard College in 1968, a master's degree in statistics from the University of California at Berkeley in 1970, and a Ph.D. in Economics from Berkeley in 1974, specializing in industrial organization and econometrics. He has taught and published research in the areas of microeconomics, theoretical and applied econometrics, and telecommunications policy at academic institutions (including the economics departments of Cornell University, the Catholic University of Louvain in Belgium, and the Massachusetts Institute of Technology) and at research organizations in the telecommunications industry (including Bell Laboratories and Bell Communications Research, Inc.). He has participated in telecommunications regulatory proceedings before state public service commissions, the Federal Communications Commission and the Canadian Radio-Television and Telecommunications Commission concerning competition, incentive regulation, price cap regulation, productivity, access charges, telecommunications mergers, pricing for economic efficiency, and cost allocation methods for joint supply of video, voice and data services on broadband networks.

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referee for these journals (and others) and the National Science Foundation and has served as an Associate Editor of the *Journal of Econometrics*.

EXECUTIVE SUMMARY

This paper is a primer on the current state of carrier access markets and on the importance of granting ILEC pricing flexibility. It explains why there is an urgent need for increased flexibility. The consequences of inactivity are severe; significant economic distortions are likely. In some cases—where market forces rather than regulation already determine prices—the delay in granting flexibility has likely already resulted in welfare losses. Relief should have been granted long ago in these cases.

The current and evolving state of market forces for many carrier access services combined with the implementation of the Telecommunications Act of 1996 (the “96 Act”) establish a competitive and emerging competitive environment in which ILEC pricing flexibility is necessary to generate efficient responses to competition. Competition does not come to all service and geographic markets in the same way or at the same time. Consequently, the Commission must first rely on market forces to determine efficient outcomes and second, establish a clear framework or set of triggers that will result in flexibility as competition comes to specific markets. Since demand is not evenly distributed across customers, there is an urgent need for the Commission to act quickly. The loss of a few large customers can have severe impact on the ILECs. While competition inevitably leads to customers switching suppliers, it would be economically inefficient if customers switched to competitors, not because they were more efficient, but because regulation encouraged inefficient entry and/or prevented the incumbent from reducing prices to respond to competition. Among our major conclusions:

- There are several simple pricing flexibility principles that the Commission should follow: First, market forces are vastly superior than reliance on regulation to determine efficient levels of output, investment and price, as a result, the Commission should primarily rely on them. Second, it is essential to reduce unnecessary asymmetric obligations when the market is *first* fully opened to competitors. Third, the Commission should pursue a policy that rewards efficiency, not one that protects particular competitors. Fourth, rates should reflect specific costs and conditions in specific markets.
- Past history in telecommunications and other markets as well as economic theory suggest that welfare losses to society as a result of delaying flexibility and deregulation

can be significant.

- The Commission should immediately permit ILECs to deaverage interstate access rates so as to more closely align rates with the way they incur costs and to prevent arbitrage resulting from UNE deaveraged rates.
- Volume and term discounts and customer-specific contracts are useful strategies in competitive markets that benefit customers and prevent inefficient investment in the network. Current market conditions justify this type of pricing flexibility for many ILEC carrier access services because competitors, large and well-financed, are able to offer such pricing plans.
- There are ILEC carrier access services such as special access and dedicated transport that are already sufficiently constrained by market forces. Continued regulation of these services serves no beneficial purpose. Forbearing from regulating such services is appropriate and consistent with economic principles.
- The main effect of the existence of interconnection agreements with UNEs at cost-based rates is to make many ILEC customers potential CLEC customers, constrained only by the ability to convince end users to switch to the CLEC. Many ILEC customers, therefore, are immediately vulnerable to competitors and as such the existence of interconnection agreements should give the Commission a sense of urgency to act by permitting market forces to substitute for regulatory constraints.
- For those remaining carrier access services where competitive forces are not, at present, sufficiently developed to constrain prices, our recommendation is to implement objective criteria which identify the stages of competition in individual markets at which regulation should be reduced with the ultimate objective of eliminating regulation.

I. INTRODUCTION

The passage of the Telecommunications Act of 1996 and the adoption of the Commission's Interconnection Order¹ have significantly and permanently increased the ability of competitive local exchange carriers (CLECs)² to compete for local exchange and carrier access customers.³ Prior to these events, economic and technological forces had already begun to reduce economic barriers to entry: competitive access providers (CAPs)⁴ increasingly supplied special⁵ access services in competition with the incumbent local exchange carrier's (ILEC's) switched and special (exchange) access services. These trends—apart from the 96 Act or any Commission action—have continued and advanced to such an extent that competitors' incentives to enter as facilities providers are growing and expanding at an increasingly fast pace. More recently, the Commission's Orders implementing the 96 Act have permitted competitors to share in the economies of scale, scope and density that permeate local exchange markets. Competitors need no longer duplicate the ILEC's network but rather can use all or part of that network to compete for retail local exchange and carrier access customers, purchasing unbundled network elements (UNEs) and interconnection from the ILEC. This makes most ILEC customers potential competitive targets, with competitors constrained only

¹ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Report and Order*, 11 FCC Rcd 15499 (1996) *vacated in part and aff'd in part sub nom. Iowa Utilities Board; Order on Reconsideration*, 11 FCC Rcd 13042 (1996); *Third Order on Reconsideration and Further Notice of Proposed Rulemaking*, CC Docket Nos. 96-98, 95-185, FCC 97-295 (rel. Aug. 18, 1997); *Iowa Utilities Board v. FCC*, Nos. 96-3321, et al. (8th Cir. July 18, 1997).

² CLECs are new local exchange competitors that have entered an area traditionally served only by a single incumbent exchange carrier (ILEC). Thus, AT&T is a CLEC where it offers local exchange service, as is an established local exchange company that has entered a new serving area.

³ Local exchange customers are residential and business end users who buy access to the public switched network, local usage and vertical services (e.g., call waiting). Carrier access customers are long distance suppliers who purchase carrier access to originate and terminate traffic in the local exchange. Carrier access is the process by which Interexchange Carriers (IXCs) like AT&T or MCI interconnect to the local exchange networks.

⁴ Examples of CAPs are WorldCom-MFS and ACS1.

⁵ Special access is a dedicated form of carrier access, essentially a private line between the interexchange carrier ("IXC") and a high-volume end user.

by their ability to convince customers to switch.⁶ Current marketplace conditions in carrier access markets are such that the Commission can safely rely on market forces to constrain many prices, rather than being forced to employ archaic regulatory rules that hinder the development of efficient competition.

What strategies make sense in markets subject to different amounts of competitive pressures? As a general economic principle, where market forces are sufficiently robust, they should be permitted to determine results. Where regulation is still required to protect some customers for some services, that regulation must not be permitted to determine results permanently. As local markets become increasingly open to competition, there is an urgent need for the Commission to act quickly to ensure that regulation is competitively neutral. Demand is not evenly distributed across customers, and the loss of a few large customers can have a severe financial impact on the market.⁷ While permitting competition inevitably leads to customers switching suppliers, it would be seriously inefficient if customers switched to new suppliers not because they were more efficient but because regulations prevented the incumbent from competing. Any delay in granting pricing flexibility to the ILEC in markets where competitive forces are already strong will inevitably result in this narrow, and most mobile, segment of the market moving to competitors, with the incumbent unable to respond. The availability of interconnection agreements (with UNEs at cost-based prices) combined with the presence of facilities-based competitors immediately establishes the need for extensive ILEC pricing flexibility in order to ensure competitively neutral regulation and permit competition to produce hoped-for efficiencies.

⁶ The recent decision of the Eighth Circuit Court of Appeals (*Iowa Utilities Board v. FCC*, Nos. 96-3321, et. al. 8th Circuit July 18, 1997) determines that ILECs are not required to recombine unbundled network elements (e.g., a loop and a port) when they are purchased by a CLEC. As a practical matter, however, UNEs remain an effective substitute for ILEC switched access for many customers because the CLEC (i) can negotiate with the ILEC to rebundle elements or (ii) can recombine UNEs itself, e.g., using physical or virtual collocation to recombine an unbundled loop and a port.

⁷ Entrants have the ability to target only a few geographic areas and yet obtain significant revenues. In the BellSouth region, for example, almost one third of all BellSouth's South Carolina business revenues are generated by business customers served by only 5 of the 115 wire centers currently operating in South Carolina. Affidavit of Gary M. Wright, *In the Matter of Application of BellSouth Corporation to Provide In-Region, InterLATA Long Distance Services under Section 271 of the Telecommunications Act of 1996*.

In combination with current market conditions, the availability of UNEs requires that carrier access services such as special access and dedicated transport⁸ be immediately removed from regulatory constraints. These services satisfy the requirements for regulatory forbearance⁹ because competitive forces in these markets are sufficiently developed to constrain market power. Similar circumstances now apply in some switched access markets where, for certain customers in certain geographic areas, the ILEC's market power is constrained by actual and potential competition from facilities-based competitors.¹⁰ Permitting market forces to determine prices, output and levels of investments in these markets is vastly superior to economic regulation. For competition to be efficient, regulatory constraints must, therefore, immediately adapt as well.

As experience has shown, carrier access services are not homogenous. Competition in markets for access services will develop at different rates. Because the carrier access market is not a monolith, if all ILECs had to wait until competition reached all geographic and customers segments, most would not get relief until it was far too late. Accordingly, it is imperative that the Commission implement workable procedures to identify markets for which residual regulation is necessary and to establish a clear and achievable path for the ILECs' services to move through degrees of pricing flexibility and ultimately to regulatory forbearance in a manner that is responsive to increases in potential and actual competition. In these cases, as in general, the Commission's ultimate goal should be that of the 96 Act: to substitute market forces for regulation.

⁸ Dedicated transport is a transmission service provided on circuits dedicated to the use of a single IXC or other person.

⁹ According to Section 10(a) of the Telecommunications Act of 1996, the Commission can forbear from regulation of a service if: enforcement of the rule or regulation is not necessary to ensure that rates are just and reasonable or not unjustly or unreasonably discriminatory; enforcement of the rule or regulation is not necessary for the protection of consumers and forbearance is consistent with the public interest.

¹⁰ Facilities-based competitors in the local exchange and carrier access markets include CAPs and other CLECs that build their own networks, (augmenting them to a varying degree with facilities (UNEs) purchased from the ILEC).